No. 3844

United States
Circuit Court of Appeals
For the Ninth Circuit

In the Matter of C. F. Mason & William McDee Owen, Co-partners as Mason & Owen,
Bankrupts.

Geo. P. Kier, Trustee,
Appellant,

J. E. Steer,
Appellee.

Petition for Re-Hearing

Upon Appeal from the United States District Court for the Southern District of California, Southern Division

Frye & Smith, Printers, San Diego, Cal.

IN THE

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To the Honorable the Judges of the above named Court:

The filing of a petition for re-hearing is an ungracious task as it gives the petitioner the appearance of being a critic of the court,—a role which we disclaim. We do wish, however, to point out to the court wherein it seems to us that the *facts* of the case have been misunderstood

and to indicate wherein we have not been given the benefit of the facts shown by the record on this appeal.

The essential point, boiled down, is that the evidence shows that *all* of the stocks found in the Logan & Bryan pledge, the margin stock as well as the "fully paid" stock, was placed there *tortiously* and therefore the equities are equal and no preference should be accorded the latter stock. We are very earnest in our contention that the evidence shows that *all* the stocks were in the pledge *tortiously,* and will explain, as briefly as possible, wherein our contention is supported by the record and wherein Your Honors have misinterpreted or overlooked essential parts of the record.

THE COURT IS IN ERROR IN ASSUMING THE EVIDENCE SHOWS THAT 100 SHARES OF MIDVALE WERE KEPT ON HAND FOR STEER.

We wish first to show that *Gorman* vs. *Littlefield,* 229 U. S., 19, is not a controlling authority herein. That case was decided in favor of the claimant of the stock there in question on the ground that it was in the *broker's* possession at time of bankruptcy. We don't question the correctness of that ruling. When Mason & Owen failed there was found in their possession a number of securities claimed and identified by various customers. Those securities were promptly surrendered to the customers by the trustee in bankruptcy on the strength of the *Gorman* decision, for the simple reason that the stocks were not in the Logan & Bryan pledge but were in the possession of the *brokers.*

If this Midvale stock had been found in the broker's possession we would have surrendered it also.

Now, what we claim is that the court has erroneously assumed that the record shows that this Midvale stock *was* in the brokers' possession, thus bringing it within the ruling in the *Gorman* case, whereas the *contrary* is the fact.

In the opinion herein it is said:

> "It is a fair presumption that Mason & Owen *kept 100 shares of Midvale stock on hand at all times for the customer.*" (Our italics.)

The above excerpt from the opinion seems to have resulted from a mistake on the part of the court as to what the record shows. The record shows affirmatively with great clearness that the Midvale stock *never* left the hands of Logan & Bryan. In the stipulated facts it is said:

> "Steer has since said date (date of purchase) permitted said stock to remain in the hands of Mason & Owen's brokers, Logan & Bryan, and that said stock is now held by said Logan & Bryan in their New York office in the account of said Mason & Owen." (Record, p. 4.)

It was also stipulated that this was the *only* Midvale stock held by either Mason & Owen or Logan & Bryan (Record 6).

Appellee recognized that fact and stated on p. 5 of his brief that the stock was held by Logan & Bryan *since the date of purchase.*

So we say that the assumption by the court that the brokers (Mason & Owen) kept 100 shares of Midvale on hand is not supported by the record, but, on the contrary, the record shows *affirmatively* that the stock

claimed by him was *never* in the brokers' possession, having been purchased by Logan & Bryan and held by them "from the date of purchase."

Neither can it be claimed that Logan & Bryan held the Midvale stock for Steer because the letter of Mr. Sterling (one of the partners of Logan & Bryan) which was accepted as evidence by stipulation of the parties (Record 12) stated as follows:

> "At the time we purchased the Midvale stock above referred to we had no knowledge, and never since then had any knowledge, of any kind that the stock was being purchased for any one but Mason & Owen." (Record 11.)

We therefore ask Your Honors to assume for the purpose of this petition that the Midvale stock was at all times in the possession of the pledgees, Logan & Bryan, and subject to the general loan.

THE RIGHTS OF MARGIN TRADERS.

Having, we trust, shown that the *Gorman* decision did not deal with a case where stocks were held under a pledge and does not preclude this court from considering and adjusting the equities as between so-called "margin" stock and "fully-paid" stock when they are found *commingled in one pledge,* we desire to explain what is meant by "margin" trading, and we wish to do this because we believe that Your Honors have an incomplete understanding of the status of "margin" stock.

In the opinion herein it is said:

> "It does appear that the marginal traders paid Mason & Owen a percentage of the purchase price of their stocks and that the pledge of the stock so

purchased was necessary in order to borrow money to carry the unpaid balances. *Thus it is inferable that the credit of these pledged stocks enabled the bankrupts to speculate, and in such speculation they lost.*

"Under *SUCH* circumstances it would be inequitable to hold that Steer, who paid his money in full and who had no pledge or loan, should be required to pay more and thus reduce the losses of the marginal traders who were speculating on the market." (Our italics.)

It is apparent from the above excerpt that this court intended to apply the rule that equality is equity but that where equities are unequal those having the superior equity will be preferred to those having an inferior equity. It is equally clear that the court was of the opinion (a) that the "margin" traders had actually or impliedly consented to the pledge of their stocks and (b) that it was the credit of those "margin" stocks that enabled Mason & Owen to speculate and cause the losses to the customers.

These two conclusions of the court are conclusions, or rather inferences, of *fact,* and we wish to respectfully point out that the facts are *exactly the reverse of what the court has accepted as facts,* that is to say, that the "margin" traders did not, inpliedly or otherwise, consent to the pledge of their stocks (except for the amount of their unpaid balances) and that *it was the credit of the "fully paid" stocks and not the "margin" stocks that enabled Mason & Owen to speculate and lose.* If we are correct as to these points then the foundation for the alleged superiority of Steer's equitable rights fails, and all the stocks will be similarly treated.

We wish to press this claim as strongly as possible. It is very important, as there are ten other customers with claims similar to the one at bar whose stocks are being withheld awaiting the disposition of this test case, and it is for that reason important that the facts be fully understood by the court so that the decision will be on the merits.

WHAT IS A MARGIN TRADER?

Courts take judicial notice of business practices and of the general methods of carrying on the brokerage business. 23 *Corpus Juris* 65.

A "margin" trader on the stock exchange is a person who buys securities on the installment plan through the office of a stock-broker. The word "margin" is the technical or trade word used to denote a traders' equity in purchases made on the various Exchanges, either grain, stock, produce or other exchange, but the transaction is in all its essentials merely a purchase on the *installment plan* with the understanding that the balance of the purchase price is payable on demand.

There is nothing mysterious about a "margin" transaction, or reprehensible or discreditable in any way. It is a practice constantly followed by all the best banks of the country in selling bonds or other securities to their customers. The only difference is that when a customer buys through a stockbroker the installment paid by him, and which represents his "equity" in the stock, is called a "margin," whereas if he buys the same security through his bank on the same terms his first payment is called an "installment" and likewise represents his "equity."

In either case the customer is the owner of the security, and the stockbroker or the banker, as the case may be, is the pledgee of the stock and holds it as security for the payment of the balance of the purchase price. The customer has the right to pay up the balance of the purchase price and receive his stock, and the stockbroker or banker has no rights in the stock except those of a pledgee and he has no right to hypothecate the stock for a *greater* amount than the customer's unpaid balance *and if he does so it is a conversion of the stock.* (See authorities on this point *infra.*)

There seems to be a prejudice against "margin trading" that is the result of a misunderstanding. The public associates "margin trading" with stock gambling merely because most stock gamblers buy their stocks "on margin." If the same stocks were purchased from or through a bank his "margin" would be called his "equity" or "installment," but the two transactions, one through a stockbroker and the other through a banker, are identical.

Some speculators on the stock market who have large sums of money on hand pay for their stocks in full, instead of paying a "margin" and borrowing the balance, but that does not make them any the less speculators. That is to say, the question whether a trader pays cash for his stock, or part cash and the balance payable later, has nothing to do with the morality of the transaction.

The most notable example of "margin trading" was the sale of billions of dollars of Liberty bonds with which our Government financed the World War. The

bonds were sold to the public "on margin," i. e., the subscriber paid 10% down and the banks agreed to hold the bond purchased as security for the other 90%, and the bank became the pledgee of the bond to secure the unpaid balance.

The transaction was simply a purchase on the installment plan. *If the same bond had been bought on the same terms from a stockbroker it would have been called a purchase "on margin"* and the broker would be the pledgee of the bond to secure the unpaid balance. The two cases are *identical* and in either case the purchaser or "trader" is the owner of the bond and his "installment" or "margin" represents his so-called "equity" in the bond, and in neither case would the broker or banker have the right to hypothecate the security to Logan & Bryan, or any one else, for more than the unpaid purchase price due on the security and if he did so it would be a *conversion.*

The above explanation of margin stock follows *Richardson* vs. *Shaw,* 209 U. S., 365 and *Jones on Collateral Securities,* Sec 495, 496.

THE MARGIN STOCKS WERE IN THE PLEDGE WRONGFULLY AND THEREFORE HAVE EQUAL EQUITIES WITH THE MIDVALE STOCK.

Your Honors have decided that Steer's equities are *superior* to those of the margin traders and that for that reason the margin stocks should be sold first.

The record shows that the assets of Mason & Owen (including, of course, the sums due them from the margin traders) were insufficient by $55,000.00 (Record 6) to pay off Logan & Bryan's lien, i. e., Mason & Owen

had pledged these customers' stocks for an amount at least $55,000 greater than Mason & Owen's lien thereon. We concede that a broker has implied authority to pledge margin stock for a sum which, added to the down payment or "margin," amounts to the purchase price of the stock, but he cannot go beyond that and if he does he *converts the stock to his own use.*

In 9 *Corpus Juris* 544 it is said:

> "He (the broker) is guilty of *conversion* if he pledges the stock purchased for an amount greater than the amount of his lien thereon."

In *Pierson's Estate,* 46 N. Y. Supp. 557 (560) it is aid:

> "Pierson & Son, by pledging the stock with White & Co., in an amount greater than their own lien thereon, and thereafter becoming insolvent, so that the customer could not obtain his stock upon payment of the amount of Pierson & Son's lien thereon, thereby *converted the stock* (*Chester* vs. *Dickerson,* 54 N. Y. 1, 11); that is to say, the firm was estopped to deny such pledge. The event—that is, Pierson & Son's insolvency—disabled the firm from complying with their contract, and thus *completed the conversion.* No demand of the money or stock was necessary, as such demand would only be cumulative evidence of the conversion. *Ganley* vs. *Bank,* 98 N. Y. 484, 494. As between the customer and Pierson & Son, the customer was the owner of the stock; Pierson & Son the pledgee thereof, with a lien for the amount unpaid thereon by the customer. Pierson & Son had no right to so subpledge the stock as to deprive the purchaser of the right to redeem it by paying the balance due upon it. *Chapman* vs. *Brooks,* 31 N . Y., 75; *Lawrence* vs. *Maxwell,* 53 N. Y., 23. The firm's pledge of the stock with White & Co., to secure the indebted-

the losses, is not warranted by the evidence, it follows that the conclusion from such premise, i. e., that Steer's equity is superior, must fall also, and we ask Your Honors to so hold.

IN CONCLUSION.

In conclusion we say:

(a) The equities of all the pledged stocks are equal because all of them were *wrongfully* in the pledge, Steer's because it had been *paid for* and the margin stock because it was pledged *for more than the amount due thereon.*

(b) That it was not the margin stock that enabled the bankrupts to speculate and lose. *As between the fully paid stock and the margin stock the former was more responsible for the losses* because of its greater borrowing capacity when used as a part of the pledge.

We believe that every fact relied upon in this petition is supported by the record, but if Your Honors believe that there is any uncertainty as to any fact we ask that the cause be remanded for further hearing, to the end that a decision will be made upon the *merits,* and furnish a rule by which all other pending claims of customers against specific stocks may be disposed of without further litigation.

In any event we ask for a re-hearing.

Respectfully submitted,

WILL J. THAYER,

Appellant's Attorney.

Certificate of Counsel is filed herewith.